Supreme Court, U.S.
FILED
931682 APR 20 1994
OFFICE OF THE CLERK

No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

BALCOR REAL ESTATE HOLDINGS, INC., f/k/a BALCOR REAL ESTATE FINANCE, INC.,

Petitioner,

v.

H. CHRISTOPHER CLARK, Trustee of the Bankruptcy Estates of Meridith Hoffman Partners and Meridith Millard Partners,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

PETITION FOR WRIT OF CERTIORARI

RAYMOND E. STACHNIK
Counsel of Record
PAUL A. HASKINS
KATTEN MUCHIN & ZAVIS
525 West Monroe Street
Suite 1600
Chicago, Illinois 60661
(312) 902-5200
Attorneys for Petitioner

Midwest Law Printing Co., Chicago 60611, (312) 321-0220

74 pp

QUESTION PRESENTED FOR REVIEW

Whether the "ordinary business terms" element of the ordinary course of business defense in the Bankruptcy Code's preferential transfer avoidance statute, 11 U.S.C. Section 547(c)(2)(C), applies exclusively to business practices used "in ordinary circumstances, when businesses are healthy".

LIST OF PARTIES

The parties to the proceeding below were the Petitioner, Balcor Real Estate Holdings, Inc. (Balcor), f/k/a Balcor Real Estate Finance, Inc., and the Respondent, H. Christopher Clark, Trustee of the Bankruptcy Estates of Meridith Hoffman Partners, a Colorado general partnership, and Meridith Millard Partners, a Nebraska general partnership (the Trustee).

The Respondent before this Court is H. Christopher Clark, Trustee.

TABLE OF CONTENTS

	PAGE
QUESTION PRESENTED	i
LIST OF PARTIES	ii
APPENDIX	iv
TABLE OF AUTHORITIES	v
OPINIONS BELOW	2
JURISDICTION	2
STATUTE INVOLVED	2
STATEMENT OF THE CASE	3
I. INTRODUCTION	3
II. THE LOAN TRANSACTIONS	3
III. THE OPINIONS BELOW	6
REASONS FOR GRANTING THE WRIT	8
I. THE DECISION BELOW CREATES A SHARP SPLIT IN CIRCUIT AUTHORITY AS TO THE MEANING AND APPLICATION OF 11 U.S.C. § 547(c)(2)(C), THE ORDINARY BUSINESS TERMS ELEMENT OF THE BANKRUPTCY CODE'S ORDINARY COURSE OF BUSINESS DEFENSE	8
II. THE DECISION BELOW IS IN CONFLICT WITH THIS COURT'S TEACHING, IN *BARNHILL v. JOHNSON*, THAT THE PURPOSE OF SECTION 547(c)(2) IS TO ENCOURAGE CREDITORS TO "DEAL WITH TROUBLED DEBTORS"	17
CONCLUSION	18

APPENDIX

	App. Page
Clark v. Balcor Real Estate Finance, Inc. (In re Meridith Hoffman Partners), 12 F.3d 1549 (10th Cir. 1993)	1
Clark v. Balcor Real Estate Finance, Inc. (In re Meridith Hoffman Partners), No. 92-1337, (10th Cir. Jan. 20, 1994) (Order—Rehearing Denied)	15
Clark v. Balcor Real Estate Finance, Inc. (In re Meridith Hoffman Partners), 145 B.R. 682 (D. Colo. 1992) (Memorandum Decision on Appeal)	17
Clark v. Balcor Real Estate Finance, Inc. (In re Meridith Hoffman Partners), Adv. Proc. No. 91-1338-SBB, slip op. (Bankr. D. Colo. April 30, 1992) (Findings of Fact, Conclusions of Law, and Order; and Judgment)	29
11 U.S.C. § 547(c)	46

TABLE OF AUTHORITIES

Cases PAGE

Barnhill v. Johnson, ___ U.S. ___, 112 S.Ct. 1386 (1992) 9, 17-19

Clark v. Balcor Real Estate Finance, Inc. (In re Meridith Hoffman Partners), 12 F.3d 1549 (10th Cir. 1993) 2, 6-8, 13

Clark v. Balcor Real Estate Finance, Inc. (In re Meridith Hoffman Partners), No. 92-1337 (10th Cir. Jan. 20, 1994) (Order—Rehearing Denied) .. 2

Clark v. Balcor Real Estate Finance, Inc. (In re Meridith Hoffman Partners), 145 B.R. 682 (D. Colo. 1992) (Memorandum Decision on Appeal) .. 2, 6-7

Fiber Lite Corp. v. Molded Acoustical Products, Inc. (In re Molded Acoustical Products, Inc.), ___ F.3d ___, 1994 WL 72656 (3rd Cir. March 11, 1994) 9, 13-15

Harman v. First American Bank of Maryland (In re Jeffrey Bigelow Design Group, Inc.), 956 F.2d 479 (4th Cir. 1992) 9, 11, 15-17

In re Tolona Pizza Products Corp., 3 F.3d 1029 (7th Cir. 1993) 8, 10-15, 17

Jones v. United Savings and Loan Assn. (In re U.S.A. Inns of Eureka Springs, Arkansas, Inc.), 9 F.3d 680 (8th Cir. 1993) 8-9, 11

Waldschmidt v. Ranier (In re Fulghum Construction Corp.), 872 F.2d 739 (6th Cir. 1989) 11

WJM, Inc. v. Massachusetts Dept. of Public Welfare, 840 F.2d 996 (1st Cir. 1988) 11

Statutes

11 U.S.C. § 547(b)(4) 4, 6
11 U.S.C. § 547(c)(2) 2, 12, 18
11 U.S.C. § 547(c)(2)(A) 11, 15-16
11 U.S.C. § 547(c)(2)(B) 10-11
11 U.S.C. § 547(c)(2)(C) ..... *passim*
28 U.S.C. § 157(b)(2)(F) 2
28 U.S.C. § 158(a) 2
28 U.S.C. § 1254(1) 2
28 U.S.C. § 1291 2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

BALCOR REAL ESTATE HOLDINGS, INC., f/k/a BALCOR REAL ESTATE FINANCE, INC.,

Petitioner,

v.

H. CHRISTOPHER CLARK, Trustee of the Bankruptcy Estates of Meridith Hoffman Partners and Meridith Millard Partners,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

PETITION FOR WRIT OF CERTIORARI

The Petitioner, Balcor, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Tenth Circuit entered in this proceeding on December 28, 1993. Balcor's Petition for Rehearing was denied by the Tenth Circuit on January 20, 1994.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Tenth Circuit affirming the decision of the United States District Court for the District of Colorado is reported at 12 F.3d 1549 and is reproduced at App. 1, *infra*. The order of the Tenth Circuit denying Balcor's Petition for Rehearing is reproduced at App. 15, *infra*. The memorandum decision of the district court affirming the decision of the United States Bankruptcy Court for the District of Colorado is reported at 145 B.R. 682 and is reproduced at App. 17, *infra*. The memorandum decision of the bankruptcy court is reproduced at App. 29, *infra*.

JURISDICTION

The judgment of the United States Court of Appeals for the Tenth Circuit was entered on December 28, 1993. The Petition for Rehearing was denied by the Tenth Circuit on January 20, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1). This case arose under 11 U.S.C. § 547. The United States Bankruptcy Court for the District of Colorado had jurisdiction pursuant to 28 U.S.C. § 157(b)(2)(F). The United States District Court for the District of Colorado had appellate jurisdiction pursuant to 28 U.S.C. § 158(a). The United States Court of Appeals for the Tenth Circuit had appellate jurisdiction pursuant to 28 U.S.C. § 1291.

STATUTE INVOLVED

This case involves 11 U.S.C. § 547(c)(2). Section 547(c) is reprinted in its entirety at App. 46.

STATEMENT OF THE CASE

I. INTRODUCTION

This case began as an adversary proceeding in the consolidated Chapter 7 bankruptcy cases of Meridith Hoffman Partners (Hoffman), a Colorado general partnership, and Meridith Millard Partners, a Nebraska general partnership (Millard). Balcor, a commercial real estate lender and the largest creditor of both of the bankruptcy estates, financed two shopping center properties owned by Hoffman and Millard, respectively.

The Trustee of the bankruptcy estates brought the adversary proceeding to recover, as allegedly avoidable, preferential insider transfers, the sum of $395,851.38 in loan repayments made by Hoffman and Millard to Balcor during the one year period preceding the filing of involuntary bankruptcy petitions against Hoffman and Millard, by their general partners, on May 8, 1989.[1]

II. THE LOAN TRANSACTIONS

Lawrence Fiedler, the Meridith Organization and Gregory Rice were general partners of both Hoffman and Millard. Hoffman owned the Hoffman Heights Shopping Center in Aurora, Colorado. Balcor made a $3,550,000 mortgage loan to Hoffman on January 30, 1985. The loan was subsequently modified and the principal amount due Balcor was increased to $3,600,000. Millard owned the Millard Plaza Shopping Center in Omaha, Nebraska. On September 8, 1986, Balcor made two separate mortgage

---

[1] The involuntary bankruptcy petitions were first filed under Chapter 11. The Millard and Hoffman bankruptcies were converted to Chapter 7 cases on August 6, 1990, and August 10, 1990, respectively.

loans to Millard, one in the amount of $5,000,000 and the other in the amount of $300,000. Fiedler and the Meridith Organization guaranteed the loans to Hoffman and Millard.

As part of subsequent loan modifications, Balcor and Hoffman and Balcor and Millard entered into escrow agreements which modified the loan repayment terms of the pre-existing real estate loan agreements. The Hoffman escrow agreement was effective October 3, 1986, two years and seven months before the filing of the Hoffman bankruptcy on May 8, 1989, and one year and seven months before the start of the one-year insider preference period under 11 U.S.C. § 547(b)(4). The Millard escrow was effective December 1, 1987, one year and five months before the Millard bankruptcy filing, and five months before the start of the one-year insider preference period. The Hoffman and Millard escrows were identical in all material respects. The Hoffman and Millard escrow payment procedures, once in place, were not altered by the parties before or during the preference period.

Similar escrow agreements were in place on two other Meridith-owned properties financed by Balcor, Wardway Plaza and Grand Island. Gregory Rice, a general partner of Hoffman and Millard and the president of Banc Property Services, Inc. (Banc), the property manager for both shopping centers, testified at the bankruptcy court trial that, of the eight or nine other Meridith-owned properties managed by Banc and not financed by Balcor, at least two had escrow agreements in place. Rice testified that such escrows were used with some frequency in those parts of Colorado where Banc had done business. Rice also testified that, in his experience, developers entered into such escrow agreements when lenders wanted more "comfort level" that revenues generated by properties were not being diverted and that the property securing the loans was being maintained.

Daniel A. Duhig, Balcor's First Vice President, gave unrefuted testimony that Balcor entered into the Hoffman and Millard escrows at the request of the borrowers, and that the terms of the escrows were common to commercial real estate loans.

Banc, the manager of the properties, and Jesse N. Lipschuetz, one of Fiedler's attorneys and the escrow agent, were also parties to the escrow agreements. Under both escrows, Lipschuetz deposited all shopping center rents and revenues into accounts maintained by Banc, which in turn prepared checks for payment of expenses and debt service. Both escrows granted Balcor an expense-payment monitoring facility under which Balcor could review all proposed expenditures by Banc, prior to disbursements. Lipschuetz and Rice both testified that the escrows were created as a means of ensuring that rent-based revenue streams were not diverted to uses unrelated to Hoffman and Millard obligations. Rice also testified that Fiedler wanted the escrows in order to assure Balcor that all creditors of Hoffman and Millard would be paid.

The bankruptcy trial court record established that until immediately prior to the bankruptcy filings when Hoffman and Millard stopped making payments to any of their creditors, all trade creditors of Hoffman and Millard were paid during the two year and seven month term of the Hoffman escrow and the one year and five month term of the Millard escrow. The only payments Balcor refused to authorize during those time periods were two payments requested by Banc for services unrelated to the properties and national trade convention expenses, and one payment requested by Lipschuetz for legal fees unrelated to the properties.

III. THE OPINIONS BELOW

After the trial of the adversary proceeding, on April 30, 1992, the bankruptcy court issued its Order. The court made the following findings material to the issues raised in this Petition:

(1) The escrow payments at issue were made while Hoffman and Millard were insolvent;

(2) The escrow payments at issue were voidable preferential transfers for the benefit of insiders (the guarantors, not Balcor) within the meaning of 11 U.S.C. § 547(b)(4), and the preference period was extended from 90 days to one year under the insider-transfer rule;[2]

(3) Balcor did not usurp control over the debtors' businesses and finances, and thus Balcor was not an insider of the debtors;

(4) The loan payments under the escrows represented an "unusual debt collection" practice; and

(5) The loan payments were not made in the ordinary course of business; the payments did not qualify for that statutory exception to the preferential transfer avoidance rule, 11 U.S.C. § 547(c)(2). (App. 34-8, 40-2)

Balcor initially appealed the bankruptcy court decision to the United States District Court for the District of Colorado. The district court affirmed in all respects. 145 B.R. at

---

[2] Whether Section 547(b)(4)(B), the insider preference rule, may apply at all to transfers to outsider creditors that benefit insider guarantors, is not a question raised in this Petition. While Balcor raised that issue in the courts below, Balcor recognizes that the rule favoring avoidance of such outsider transfers, though widely criticized in the scholarly literature, has been accepted by the circuits that have reached the issue.

686-8. (App. 23-4, 26-7) Subsequently, Balcor appealed the district court decision to the United States Court of Appeals for the Tenth Circuit. The Tenth Circuit affirmed the decision that the ordinary course of business defense did not apply to the Balcor transfers. 12 F.3d at 1554. (App. 5-6)

Construing the statute's intent, the court stated that even commonly used business practices cannot constitute "ordinary business terms", unless those practices are of a type used in "ordinary situations":

> The Code does not define "ordinary business terms": The phrase could mean terms that creditors in similar situations commonly would use, even if the situation itself is extraordinary. *See Jones v. United Savings & Loan Ass'n. (In re U.S.A. Inns)*, No. 93-1631, 1993 WL 444162, at *5 (8th Cir. Nov. 4, 1993) (Subsection (c)(2)(C) "requires evidence of prevailing practice among similarly situated members of the industry facing the same or similar problems." *Morris v. Kansas Drywall Supply Co. (In re Classic Drywall, Inc.)*, 121 B.R. 69, 75 (D. Kan. 1990) ("If an accepted or common practice of the industry, it is an 'ordinary business term.' "). Or it could mean terms that are used in usual or ordinary situations. *We think that the purposes of the preference section suggest the latter meaning.*

Id. at 1553. (App. 4) (Emphasis added.)

The court then held that "ordinary business terms" is defined as follows:

> Ordinary business terms are therefore those used in "normal financing relations": *the kinds of terms that creditors and debtors use in ordinary circumstances, when debtors are healthy.*

Id. (App. 5) (Emphasis added.)

In the application of that holding to the escrows in question, the Tenth Circuit found that the escrows were not ordinary business terms. The court stated:

> The escrow arrangement with Balcor was not a normal financing relationship. The record shows that creditors in the industry only use such an arrangement in extraordinary circumstances, when debtors are in trouble.

Id. at 1554 (App. 5)

REASONS FOR GRANTING THE WRIT

I.

THE DECISION BELOW CREATES A SHARP SPLIT IN CIRCUIT AUTHORITY AS TO THE MEANING AND APPLICATION OF 11 U.S.C. § 547(c)(2)(C), THE ORDINARY BUSINESS TERMS ELEMENT OF THE ORDINARY COURSE OF BUSINESS DEFENSE.

In its unprecedented interpretation of the "ordinary business terms" element, the Tenth Circuit has altered the realties of the business world so that the only "ordinary" businesses are "healthy" businesses. In such an idealistic marketplace, a statutory exception designed to help save troubled businesses from bankruptcy could be invoked only if those businesses could operate as if they were trouble-free.

The Tenth Circuit's ultra-narrow construction of the "ordinary business terms" element of the "ordinary course of business" exception directly conflicts with authorities on point from the Seventh, Eighth and Fourth Circuits that recognize § 547(c)(2)(C) as a broadly inclusive method to measure ordinariness within a lending industry that routinely deals with businesses in trouble. *In re Tolona Pizza Products Corp.*, 3 F.3d 1029 (7th Cir. 1993); *Jones v. United Sav. and Loan Assn. (In re U.S.A. Inns of Eureka*

Springs, Arkansas, Inc.), 9 F.3d 680 (8th Cir. 1993); *Harman v. First American Bank of Maryland (In re Jeffrey Bigelow Design Group, Inc.)*, 956 F.2d 479 (4th Cir. 1992).

The "healthy business" restriction invented below also contradicts this Court's teaching that the very purpose of the Section 547(c) defenses to preference avoidance, including the ordinary-course defense, is to encourage dealings with "troubled debtors." *See Barnhill v. Johnson*, ___ U.S. ___, 112 S.Ct. 1386, 1391 (1992), *aff'g In re Antweil*, 931 F.2d 689 (10th Cir. 1989).

Indeed, the Tenth Circuit opinion departed from all pre-existing case law in holding that, when Congress wrote "ordinary business terms", what Congress really meant was "the kind of terms that creditors and debtors use in ordinary circumstances, *when debtors are healthy*." 12 F.3d at 1553 (App. 5) (Emphasis added.) It comes as no surprise that for such a key proposition of law, the opinion below identifies no supporting authority whatsoever.

No other circuit had previously imposed a "healthy business" restriction on the "ordinary business terms" requirement. Recently, the Third Circuit paradoxically endorsed the Tenth Circuit's "healthy business" standard, even as it adopted and expanded the Seventh Circuit's broadly inclusive standard of ordinariness within an industry. *Fiber Lite Corp. v. Molded Acoustical Products, Inc. (In re Molded Acoustical Products, Inc.)*, ___ F.3d ___, 1994 WL 72656 (3rd Cir. March 11, 1994). That paradox is fully discussed below.

Each other circuit that has held that § 547(c)(2)(C) creates an objective standard, as the Tenth Circuit did here, has construed "ordinary business terms" to encompass industry practices characteristic of businesses in questionable financial health. The majority rule, in fact, focuses on whether a given business practice has attained some threshold level of recognition—as distinct from dominance—

within an industry, either irrespective of the fiscal fitness of businesses engaged in that practice or with an emphasis on the practices of businesses with similar financial problems.

The Seventh Circuit, in *Tolona*, has construed the "ordinary business terms" provision to embrace the broad range of practices in which firms generally *similar to the creditor* engage. *Tolona*, 3 F.3d at 1033 (7th Cir. 1993). Not only is the "health" of the debtor immaterial to the *Tolona* analysis, the reference point for the test is the creditor, not the debtor. *Tolona* holds that only business practices "so idiosyncratic as to fall outside that broad range should be deemed extraordinary and therefore outside the scope of subsection (C)." *Id.* It follows, necessarily, from the *Tolona* rule that "ordinary business terms" include practices employed by businesses similar to creditors who regularly must deal with debtors in some financial difficulty.

The Seventh Circuit's expansive reading of subsection 547(c)(2)(C) is grounded in two basic convictions: 1) that the "ordinary business terms" requirement, though mandating application of an objective, industry-based standard, is a lesser element of the ordinary-course-of-business defense than the section's cornerstone, subsection (c)(2)(B), which provides that a transfer must arise in the ordinary course of business between the debtor and creditor, *Id.* at 1032;[3]

---

[3] On that point, *Tolona* states:

> From this standpoint, however, the most important thing is not that the dealings between the debtor and the allegedly favored creditor conform to some industry norm but that they conform to the norm established by the debtor and the creditor in the period before, preferably well before, the preference period.

3 F.3d at 1032.

and 2) that the law should not push businesses to agree on a single set of billing practices, as "the relevant business and financial considerations vary widely among firms . . .", *Id.* at 1033.

The Tenth Circuit opinion, however, inverts that priority. The Tenth Circuit concluded, at the threshold, that it need not address the first two elements of ordinary course of business exception, subsection 547(c)(2)(A) and (B), because the escrow payments failed to satisfy the third element, subsection (c)(2)(C), the "ordinary business terms" requirement. 12 F.3d at 1553. Thus, for want of evidence of business practices associated exclusively with "healthy" businesses, the Tenth Circuit rejected the ordinary-course defense without even beginning the critical analysis of prior dealings between the debtor and creditor pursuant to subsection (c)(2)(B). Had that analysis been performed, presumably the court would have been compelled to address the crucial, undisputed trial evidence that: 1) the Hoffman escrow was operational fully one year and seven months before the start of the one-year insider preference period, and the Millard escrow was operational fully five months before the preference period commenced; and 2) both escrows operated on the same basis before and during the one-year preference period. Besides the Seventh Circuit in *Tolona*, several other circuits have found that the primary focus of defense is the prior dealings between the parties. *See, e.g., Jeffrey Bigelow*, 956 F.2d at 486-8; *Waldschmidt v. Ranier (In re Fulghum Constr. Corp.)*, 872 F.2d 739, 743 (6th Cir. 1989); *WJM, Inc. v. Massachusetts Dept. of Public Welfare*, 840 F.2d 996, 1011 (1st Cir. 1988).

In even sharper contrast to the opinion below, the Eighth Circuit has held that "ordinary business terms" comprise business terms associated with businesses facing problems, as distinct from healthy businesses. *U.S.A. Inns*, 9 F.3d at 685. *U.S.A. Inns*, acknowledging the legislative

history of § 547(c)(2) and prior judicial construction, concluded that:

> [T]he focus of subsection (c)(2)(C) should be on whether the terms between the parties were *particularly unusual* in the relevant industry, and that evidence of a prevailing practice among *similarly situated members of the industry facing the same or similar problems* is sufficient to satisfy section (c)(2)(C)'s burden.

Id.[4] (Emphasis added.)

At issue in *U.S.A. Inns* was whether the ordinary course defense applied to otherwise avoidable preferential transfers consisting of real estate loan repayments that were delinquent, irregular and less than the agreed dollar amount. *Id.* at 682. An officer of the creditor (a savings and loan) testified that "probably eight to ten percent" of the creditor's accounts were on pay schedules similar to the debtor's—certainly not a prevalent practice. *Id.* at 685. That officer, however, also testified that it was a "regular practice in the savings and loan industry to work with *delinquent customers* as long as some type of payment is forthcoming. . ." *Id.* (Emphasis added.)

The bankruptcy court in *U.S.A. Inns* had found that the creditor had not met its evidentiary burden, under § 547(c)(2)(C), in that the creditor "presented no evidence that the late note payments were so common within the savings and loan industry that it could be considered an ordinary business practice. . ." *Id.* at 682. The district court reversed, and the Eighth Circuit affirmed, expressly relying on the testimony of the savings and loan officer that it was a regular industry practice to work with delinquent custom-

---

[4] *U.S.A. Inns* also expressly adopts the *Tolona* rule, *supra.*, that all non-idiosyncratic practices within the broad range of industry practices are "ordinary" under subsection (c)(2)(C). 9 F.3d at 685.

ers. *Id.* at 682, 685-6. Applying its "not particularly unusual" standard, the Eighth Circuit found that the late, irregular payments were indeed made according to "ordinary business terms." *Id.* at 685-6.

It is impossible to reconcile the Eighth Circuit's ruling that late, irregular, deficient payments from a troubled debtor are not "particularly unusual", with the ruling below that payments under escrow agreements in place several months before the start of the transfer avoidance period are unusual. Here, as in *U.S.A. Inns*, Balcor dealt with Hoffman and Millard at arm's length, agreeing to an escrow mechanism that was a recognized industry practice, according to the testimony of one of the debtors' partners and property manager, Gregory Rice.[5]

In its recent decision, the Third Circuit also expressly adopted the Seventh Circuit's interpretation, in *Tolona*, of what "ordinary business terms" means. *Molded Acoustical*,

---

[5] Significantly, the Tenth Circuit opinion neither rejects nor acknowledges the finding of the bankruptcy court, or the affirmance of that finding by the district court, that Balcor exerted no insider control over the debtors through its role in monitoring the escrow payments, and thus was not an insider. Relying solely on the Trustee's rendition of the facts, the Tenth Circuit found that Balcor used the escrows to favor itself over other creditors by denying or delaying payments to others in order to assure payments on its mortgages with Hoffman and Millard. 12 F.3d at 1554. (App. 6). The Tenth Circuit did not even address trial testimony from Lipschuetz, the escrow agent, that Balcor and all of the trade creditors were paid under the escrows. The court also did not acknowledge unrefuted trial evidence that the only creditor bills that went unpaid as a result of Balcor's expense-monitoring role were either improper Banc or Lipschuetz expense claims unrelated to the Hoffman or Millard operations.

1994 WL 72656 at *6.[6] Indeed, the Third Circuit embellished the rule of *Tolona*, by giving great weight to the length and nature of the relationship between the creditor and debtor in its interpretation of § 547(c)(2)(C):

> In sum, we read subsection C as establishing a requirement that a creditor prove that the debtor made its pre-petition preferential transfers in harmony with the range of terms prevailing as some relevant industry's norms. That is, subsection C allows the creditor considerable latitude in defining what the relevant industry is, and even departures from that relevant industry's norms which are not so flagrant as to be "unusual" remain within subsection C's protection. In addition, when the parties have an enduring, steady relationship, one whose terms have not significantly changed during the pre-petition insolvency period, the creditor will be able to depart substantially from the range of terms established under the objective industry standard inquiry and still find a haven under subsection C.

Id. at *9. That reasoning clearly favors a finding of ordinariness here, where the escrows were operational and unchanged from well prior to the start of the one-year preference period until the bankruptcy filings.

At the same time, *Molded Acoustical* also cited the opinion below in stating, "We think ordinary business terms

---

[6] The Third Circuit deviated from *Tolona* only by substituting the word "unusual" for "idiosyncratic" as follows:

> . . . [O]nly dealings so unusual as to fall outside that broad range should be deemed extraordinary and therefore outside the scope of subsection C.

Id.

are those which prevail in healthy, not moribund, creditor-debtor relationships." *Id.* at *9, *citing In re Meridith Hoffman*, 12 F.3d at 1553. In the very next sentence of the opinion, however, the Third Circuit acknowledged the contrary holding of *U.S.A. Inns* that "evidence of a regular practice in the savings and loan industry of working with delinquent customers on special terms [is] sufficient to satisfy subsection C." *Id.*, *citing U.S.A. Inns*, 9 F.3d at 685.

Thus, *Molded Acoustical* underscores the doctrinal confusion created by the Tenth Circuit's "healthy business" requirement while, at the same time, expanding the rule of *Tolona* that § 547(c)(2)(C) covers the entire, broad range of business practices achieving some threshold of recognition within an industry. On balance, *Molded Acoustical* simply reinforces the fundamental split in circuit authority on the question presented and the Tenth Circuit's departure from this Court's teaching in *Barnhill*, and further establishes the need for resolution of that division and confusion.

The Tenth Circuit decision also conflicts with the Fourth Circuit's holding that debtor workout arrangements commonly used *only* by troubled debtors meet the statute's ordinariness requirement. *Jeffrey Bigelow*, 956 F.2d at 488. There the court assessed the challenged transfers, under an unconventional, three-way loan refinancing arrangement, from the perspective of other creditors, and concluded:

> Most significantly and following the purpose of the exception, these transfers must be seen as normal and usual by other creditors. An entity *encountering difficult financial times often seeks loans from reputable institutions as part of its workout efforts.*

Id. (Emphasis added.)

It should be noted that the quoted language appears in the Fourth Circuit's analysis of § 547(c)(2)(A), the first ele-

ment of the ordinary-course test requiring that the transfer at issue be in payment of a debt incurred in the ordinary course of business of the debtor and transferee (the focus of § 547(c)(2)(A) being on the ordinariness of the debt, as between the parties, rather than the ordinariness of the transfer mechanisms). Nevertheless, the quoted language clearly refers to the transfers at issue, not just the underlying debt, and supports the court's conclusion that § 547(c)(2)(C) was satisfied as well.

The Tenth Circuit focused only on the simple fact of existence of the escrows and ignored their durations and effects. On the other hand, the Fourth Circuit was able to analyze the unconventional credit arrangement under which the challenged transfers were made and distinguish between what may have not been commonplace, but nevertheless was ordinary. In specific reference to subsection (c)(2)(C), the Fourth Circuit stated:

> Admittedly, the business terms setting up these transfers may not be commonplace; however, the Code requires only ordinariness.

Id. Accordingly, the court in *Jeffrey Bigelow* held that the ordinary-course test was satisfied:

> We fail to see how these transfers could have been more ordinary. The existence of two years of regular payments on the debt indicate that the last transfers, made in the same manner, are simply following the ordinary course of business pattern between the two parties.

Id.

Since the Hoffman and Millard escrows were operational one year and seven months, and five months, prior to the *start* of the one-year insider preference periods, respectively, the same reasoning should have been used by the Tenth

Circuit in order to apply the ordinary course defense uniformly. Instead, the important comparison of the parties' relations before and during the preference periods which was so strongly emphasized in *Jeffrey Bigelow*, *Tolona* and *Molded Acoustical* was ignored by the Tenth Circuit.

In sum, *Tolona*, *U.S.A. Inns*, and *Jeffrey Bigelow* all stand for an inclusive construction of the "ordinary business terms" provision, one in which "ordinariness" extends to the full panoply of business practices common to businesses facing common problems, so long as those practices are not particularly unusual or idiosyncratic. Those consistent, practical views simply cannot be reconciled with the rule of the Tenth Circuit, apparently adopted by the Third Circuit, construing "ordinary business terms" to exclude all business terms not used in "ordinary circumstances", i.e., "when debtors are healthy."

II.

THE DECISION BELOW IS IN CONFLICT WITH THIS COURT'S TEACHING, IN *BARNHILL v. JOHNSON*, THAT THE PURPOSE OF SECTION 547(c)(2) IS TO ENCOURAGE CREDITORS TO "DEAL WITH TROUBLED DEBTORS".

Ultimately, the Tenth Circuit decision simply does not square with this Court's teaching that the congressional purpose underlying the ordinary-course exception is ". . . to encourage creditors *to deal with troubled debtors* on normal business terms by obviating any worry that a subsequent bankruptcy filing might require a creditor to disgorge as a preference an earlier received payment." *Barnhill v. Johnson*, ___ U.S. ___, 112 S.Ct. 1386, 1391 (1992), *aff'g In re Antweil*, 931 F.2d 689 (10th Cir. 1989). (Emphasis added.) It is diametrically opposed to that construction to conclude, as the Tenth Circuit did, that only terms "normal" from the perspective of healthy, non-troubled debtors can satisfy the ordinary-business-terms requirement.

Implicit in this Court's interpretation of § 547(c)(2) in the *Barnhill* formulation is the assumption that a creditor knows a "troubled debtor"—to use this Court's phrase—when it sees one. If the law only protected a creditor doing business with a recognizably troubled debtor on business terms "normally" associated only with a secure, "healthy" debtor, as the Tenth and Third Circuits have held, the creditor's incentive to deal will cease to exist and bankruptcy filings will multiply.

CONCLUSION

When each of the circuit decisions discussed above is analyzed, only the "healthy business" rule is fundamentally incompatible with this Court's teaching in *Barnhill* that the ordinary-course defense was intended to encourage creditors to deal with troubled debtors. Thus, besides creating a recognizable split in circuit authority, the Tenth Circuit opinion injected significant confusion into the ordinary-course-of-business analysis. It certainly is more problematic to identify business terms associated exclusively with "healthy" businesses, as the opinion requires, than it is to simply identify business terms that have attained some semblance of recognition within a given industry. Indeed, the near-metaphysical threshold question implicitly raised by the decision below—what is a "healthy" business—at best invites doctrinal confusion, and at worst guarantees chaos in relationships between lenders and borrowers. For lenders and trade creditors debating whether to continue to finance or throw down the gauntlet to businesses experiencing financial downturns, and for those borrowers in need, the stakes raised by the Tenth Circuit decision hardly can be overstated. By magnifying the perceived business risk attendant to working with and extending credit to troubled debtors, the Tenth Circuit decision undermined the

very policy purpose of the ordinary course of business defense, as defined by this Court in *Barnhill*.

We respectfully urge this Court to take the case, resolve the split in circuit authority and clarify the application of a statute enacted to promote, rather than destroy, relationships between lenders and financially troubled debtors.

Respectfully submitted,

RAYMOND E. STACHNIK
Counsel of Record
PAUL A. HASKINS
KATTEN MUCHIN & ZAVIS
525 West Monroe Street
Suite 1600
Chicago, Illinois 60661
(312) 902-5200
Attorneys for Petitioner